

February 28, 2003

**VIA HAND DELIVERY**

Claims Appeals  
Reciprocal, in Receivership for Rehabilitation  
or Liquidation  
c/o Mr. Melvin J. Dillon, Special Deputy Receiver  
4200 Innslake Drive  
Glen Allen, Virginia 23060

**RE: Commonwealth of Virginia, ex rel. State Corporation Commission v.  
Reciprocal of America, The Reciprocal Group, and Jody M. Wagner,  
Treasurer of Virginia, Case No. INS-2003-00024**

**NOTICE OF APPEAL, CLAIM, REQUEST FOR IMMEDIATE STAY OF FIRST  
DIRECTIVE AS TO PAYMENTS TO ROA INSURANCE POLICY CLAIMANTS, AND  
REQUEST FOR RELIEF FROM THIRD DIRECTIVE**

Dear Special Deputy Receiver Dillon:

The Special Deputy Receivers (“SDRs”) for three risk retention groups – SDR Robert S. Brandt for American National Lawyers Insurance Reciprocal (“ANLIR”), SDR John Knox Walkup for Doctors Insurance Reciprocal (“DIR”), and SDR Michael D. Pearigen for The Reciprocal Alliance (“TRA”) (collectively, the “Reciprocal Groups” or the “Groups”), on behalf of Commissioner Paula

A. Flowers of the Tennessee Department of Commerce & Insurance, as Receiver for the Groups, hereby file this Notice of Appeal, Claim, Request for Immediate Stay of First

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Directive as to Payments to ROA Insurance Policy Claimants, and Request for Relief from Third Directive. As duly-appointed SDRs of the Reciprocal Groups<sup>1</sup>, we have rights to funds and documents in the current possession of the estate of Reciprocal of America ("ROA") and The Reciprocal Group ("TRG"), administered by you. We appeal and object, under the terms of your "Third Directive of Deputy Receiver Adopting Receivership Appeal Procedure," in Commonwealth of Virginia, ex rel. State Corporation Commission v. Reciprocal of America, The Reciprocal Group, and Jody M. Wagner, Treasurer of Virginia, Case No. INS-2003-00024 (Va. State Corp. Comm'n, effective Jan. 29, 2003), to the directives and decisions itemized below in the Statement of Objections.

The SDRs object to your making payments to some insurance claimants while refusing to pay the claims of thousands of other doctors, lawyers, counselors, hospitals, and other healthcare providers, in Virginia, Tennessee, and throughout the country, who may be foreclosed from any meaningful remedy. At the same time, we have been allowed only very limited access to the persons responsible for administering the insurance policies of these thousands of subscribers and insureds – and to the related books and records held by ROA and TRG. The funds of the ROA estate include our policyholders' money. We request that you not pay any claims until after you have fully reviewed the magnitude of all of the potential insurance claims, including claims of the Groups' insureds. We request that you immediately stop all payments to insurance claimants and review the impact on all policyholders and the

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<sup>1</sup> The Tennessee receivership proceedings are styled as State of Tennessee, ex rel., Pamela A. Flowers v. American National Lawyers Reciprocal, Davidson Chancery (Tenn.) No. 03-293-I; State of Tennessee, ex rel., Pamela A. Flowers v. Doctors Insurance Reciprocal, Davidson Chancery (Tenn.) No. 03-294-III; and State of Tennessee, ex rel., Paula A. Flowers v. The Reciprocal Alliance, Davidson Chancery (Tenn.) No. 03-295-I.

relationships among this family of companies. The ROA estate funds are being prematurely and irreversibly depleted. Therefore, we expect and insist that you will promptly review these matters.

### **I. STATEMENT OF OBJECTIONS**

We appeal from the following directives and decisions that are expressed or may be implied in the "First Directive of Deputy Receiver Continuing Insurance Policy Payments and Imposing Suspension and Moratorium on Other Claim Payments," in Commonwealth v. ROA, et al., Case No. INS-2003-00024 (Va. State Corp. Comm'n, effective Jan. 29, 2003) (the "First Directive," provided as Exhibit 1)<sup>2</sup>:

1. Directive of the Deputy Receiver that payments will continue to be made to ROA policyholders, subscribers, and third-party claimants who have claims under contracts of insurance and insurance policies (collectively, "Insurance Policy" or "Insurance Policies"), to the extent that contracts of insurance and insurance policies held by the Groups' insureds are not treated as Insurance Policies of ROA [First Directive, p. 2, Item 1]; and
2. Deputy Receiver's decision not to pay all other claims of ROA and TRG of any nature, including the payment of all creditor claims which are allegedly subordinate to Insurance Policy claims, to the extent that claims by the SDRs and/or the Groups' policyholders, subscribers, and third-party claimants are treated either as "other claims" subject to such decision or in any way as subordinate claims [First Directive, p. 2, Item 3].

We also appeal from the following directives and decisions that appear in the "Third Directive of Deputy Receiver Adopting Receivership Appeal Procedure," in Commonwealth v. ROA, et al., Case No.

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<sup>2</sup> Exhibits are being filed under seal in a separate binder. All exhibits, other than Exhibits 1-3, contain confidential, proprietary and commercially-sensitive information. They are being filed with a request that they not be disclosed to anyone other than Commission personnel, receivers and staff, and be kept under seal.

INS-2003-00024 (Va. State Corp. Comm'n, effective Jan. 29, 2003) (the "Third Directive," provided as Exhibit 2):

3. Directive that a Notice of Appeal must include all supporting documents and a full and detailed explanation of the appeal;
4. Directive that any ground or basis not presented in the Notice will be deemed waived; and
5. Directive that any subsequent appeal to the Commission may not present grounds or bases for appeal that were not presented in the preceding appeal to the Deputy Receiver.

Finally, we appeal from the following:

6. Decision of the Circuit Court and Deputy Receiver to assert exclusive jurisdiction and control over the Board members, officers, and employees of ROA and TRG, and over the books and records held by ROA and TRG, preventing or limiting full access by the SDRs and Groups to persons, books, and records, which are crucial sources of information.

The referenced directives, if not rescinded, modified, or stayed, will or may affect a financial interest, contract right, or legal entitlement of the SDRs, the Groups, and/or the Groups' subscribers and insureds. Nothing in this filing shall constitute an admission that the grounds for appeal or claim stated herein constitute or relate to "non-Insurance Policy Claims" under the terms of the First Directive or the Third Directive. Instead, the intent of the SDRs is to pursue all available remedies in this proceeding on behalf of the Groups' insureds, without excluding other remedies that may exist. Moreover, this filing is made without waiver of any rights and all rights are expressly reserved.

## **II. CLAIM**

A claim is made for all the relief requested herein, including but not limited to, full and unfettered access to and obtaining of books, records and tangible property of the Groups from the ROA estate.

## **III. STATEMENT OF FACTS**

ROA is a Virginia-domiciled reciprocal company operating since 1997 and formerly known as The Virginia Insurance Reciprocal. Its attorney-in-fact is TRG, a Virginia-domiciled insurance management company formerly known as Virginia Professional Underwriters, Inc. The Circuit Court of the City of Richmond has found that ROA and TRG “operate as, and comprise, a single insurance business enterprise.” (See Final Order Appointing Receiver for Rehabilitation or Liquidation, in Commonwealth v. ROA, et al., Case No. INS-2003-00024 (Richmond Cir. Ct. Jan. 29, 2003) (“Circuit Court Order”), provided as Exhibit 3; accord First Directive, Ex. A, ¶ 1; Third Directive, Ex. B, ¶ 1).

On information and belief: Beginning in 1990, ROA/TRG fostered, encouraged, supported and promoted the creation and expansion of DIR to insure doctors in Virginia, Tennessee, and throughout the country. Beginning in 1992, ROA/TRG fostered, encouraged, supported and promoted the creation and expansion of ANLIR to insure lawyers in Virginia, Tennessee, and throughout the country. Beginning in 1995, ROA/TRG fostered, encouraged, supported and promoted the creation and expansion of TRA to insure counselors, hospitals, and other healthcare providers, in Virginia, Tennessee, and throughout the country. The Groups entered into Management and Insurance Services Agreements with TRG (the “Management Agreements,” provided as Exhibits 4A-C), which obligated

ROA/TRG, among other duties, (1) to ensure that the Groups complied with the law, (2) to create and maintain records “for” the Groups, (3) to obtain the Groups’ informed consent to any reinsurance agreements, and (4) to submit “major programmatic changes to the operations of ANLIR” for approval by its attorney-in-fact. (Management Agreements, Ex. 4A-C, §§ 2 [all] and 4.3 [ANLIR]).

On information and belief: The Groups/TRG, and ROA/TRG before them, negotiated with state and local bar associations, medical associations, and hospital and other associations for endorsement agreements that provided the Groups with the bulk of their customer base of policyholders and subscribers. In turn, the Groups “reinsured” nearly all – and beginning on January 1, 2002, all – of their exposure through ROA. These endorsement agreements were attractive to bar, medical, and hospital and other associations because, until April 2002, ROA and the Groups maintained A (Excellent) ratings by A.M. Best Company.

On information and belief: As part of its promotion and support for the expansion of the Groups, the ROA/TRG “single insurance business enterprise” made significant financial commitments to the Groups and their state regulators. In or around 1996, ROA contracted with the Groups to “obtain, procure, make available,” or “otherwise provide” to the Groups such additional risk-based capital “as may be needed” under criteria set by the National Association of Insurance Commissioners to maintain the Groups’ A rating from A.M. Best. (See, e.g., ANLIR Surplus Support Agreement, provided as Exhibit 5). Thus, ROA/TRG provided the money necessary to maintain the Groups’ A ratings, which made the bar, medical, and hospital and other association endorsement agreements possible, which provided the Groups with their base of insureds, and which provided ROA/TRG with “reinsurance” business. ROA/TRG effectively stepped into the shoes of the Groups in order to protect its own

premium income and management fees. ROA explicitly provided in the Surplus Support Agreements that its capital commitment was dependent on the continuation of its “reinsurance” relationship with the Groups. (See, e.g., Ex. 5 § 2).

Moreover, the Board members and officers of ROA/TRG and the Groups were often the same people, creating an interlocking network of authority and control among all five companies. (See, e.g., the management biographies contained in the August 2002 ANLIR New Board Member Orientation Packet, provided as Exhibit 6).

On information and belief: In 2001, at the request of ROA’s “reinsurer,” General Reinsurance Corporation (“GRC”), GRC, ROA/TRG, and GRC’s then “reinsurer” for claims by the Groups’ subscribers and insureds, First Virginia Reinsurance, Ltd. (“FVR”), planned a loss portfolio transfer under which:

- Effective January 1, 2002, GRC was to no longer reinsure the primary or “pass through” layers of the Groups’ business. The then-current reinsurance agreement and retrocession agreement which passed the Groups’ business to FVR through GRC was to be terminated for all policies becoming effective after December 31, 2001;
- Effective January 1, 2002, GRC was to assume liability for all outstanding losses under all retrocession agreements between GRC and FVR. In exchange, FVR was to liquidate two trust accounts and make a cash payment to GRC of \$112 million, and GRC was to release approximately \$11 million of trust assets to FVR’s control;
- GRC’s total limit of liability for all pass-through business assumed from ROA on policies in force prior to January 1, 2002 was to be capped at \$135 million;
- GRC and ROA were to enter into a new reinsurance agreement (a tail cover) under which GRC would reinsure incidents occurring prior to January 1, 2002 which were then reported on policies becoming effective from January 1, 2002 to January 1, 2005;
- Pursuant to an indemnification agreement, FVR was to indemnify ROA for any losses ROA might incur from the pass-through business if the applicable losses were to exceed

the \$135 million liability cap set by GRC. ROA was to have the right to seek reimbursement from the assets maintained in the new FVR trust account (in the amount of \$11 million); and

- FVR was to enter into a Profit Sharing Agreement with GRC to require FVR to repay GRC for any shortfall between the \$112 million cash payment received by GRC and the \$135 million cap on GRC's liabilities.

(See Executive Summary of Proposed Changes to Reinsurance Relationship with General Reinsurance Corporation Regarding Business Ceded to First Virginia Reinsurance, Ltd., provided as Exhibit 7).

On information and belief: The Boards of Directors and attorneys-in-fact of the Groups' never approved this loss portfolio transfer. Despite this lack of authorization, ROA/TRG, together with GRC and FVR, implemented the loss portfolio transfer as of January 1, 2002. The transaction was not even explained to the Groups' Boards of Directors until April 2002. (See, e.g., Minutes of the April 13, 2002 Meeting of the ANLIR Board of Directors and [GRC] Proposal to First Virginia Reinsurance, Ltd., presented to DIR Board on April 5, 2002, provided as Exhibits 8A-B). FVR was and is an affiliate or related company to ROA/TRG and the Groups. As of January 1, 2002, ROA/TRG provided ANLIR and DIR with "first dollar reinsurance," in which ANLIR and DIR retained no portion of the risk associated with the policies of their subscribers and insureds. Since at least 1995, ROA/TRG provided virtual "first dollar reinsurance" to TRA. In all cases, the Groups retained either no portion of the risk associated with the policies of their subscribers and insureds, or at most a *de minimis* amount. (See Agreement of Reinsurance No. B1993 Endorsement 7; Agreement of Reinsurance No. A1993 Endorsement 9; Agreement of Reinsurance No. A1995 Exhibit A, provided as Exhibits 9A-C). Finally, ROA/TRG and the Groups have maintained a common "Agreement of Reinsurance" with GRC since at least September 1997, repeatedly signed by Mr. Kenneth R. Patterson on behalf of ROA and all three Groups. This



“Agreement of Reinsurance” stated that ROA/TRG was the “agent of the other companies.” (See Agreement of Reinsurance No. A444, provided as Exhibit 10).

Our access to the Groups' own books and records have been restricted by you and/or the Deputy Receiver and/or the State Corporation Commission, and we have not been given full and unrestricted rights to interview key personnel managing our own Groups. We respectfully refer you to a series of letters by and between Commissioners Gross and Flowers, of which we presume you have copies. The SDRs for the Groups are laboring under specific restrictions which have impeded our ability to obtain information relevant to this appeal. Upon further knowledge and investigation, we reserve the right to supplement the record for this matter.

#### **IV. POINTS OF LAW**

We are not required to provide, and do not have sufficient information to provide, a comprehensive legal analysis for the relief requested herein. However, based on the foregoing and future investigation, we respectfully submit that we may be entitled to the relief requested under numerous and alternative principles of law and equity, including but not limited to, the following.

1. **Fronting Arrangement** – ROA/TRG, through its control of the marketing and administration of the Groups' contracts of insurance and insurance policies and its “first dollar reinsurance,” created a de facto fronting arrangement with the Groups. Therefore, claims by the SDRs on behalf of the Groups' subscribers and insureds could be considered to constitute “[ROA] Insurance Policy” claims under the First Directive, entitled to equal dignity and rights of payment with all other valid “[ROA] Insurance Policy” claims.

2. **Breach of Trust/Constructive Trust** – On information and belief, the estate may be utilizing, in part, unearned premiums, loss reserves, and IBNR reserves paid by the Groups' subscribers and insureds, to pay others now in violation of express or constructive trusts for their benefit.

3. **Equitable Estoppel** – The estate may be also equitably estopped from attempting to now disavow its obligations to the Groups and their subscribers and insureds through various surplus support agreements. ROA provided the agreements to the Groups so as to procure endorsements of professional associations, increase the pools of insured and its own "reinsurance" premiums, with the promise to give its financial backing should the need ever arise.

4. **Treatment as “Hardship Claims”** – The SDRs' claims on behalf of the Groups' subscribers and insureds, given the totality of the circumstances including the interconnections among this family of companies and the likely absence of any other remedy, could and should be deemed “hardship claims” by the Deputy Receiver under the broad discretion granted by Paragraph 18(b) of the Circuit Court's Order.

5. **Constitutionally-Prohibited Discrimination Against Interstate Commerce** – The Deputy Receiver's application of Title 38.2, Chapters 12 and 15 of the Virginia Code in this receivership, through his issuance of the First Directive, may be deemed to have the purpose and/or effect of impermissibly discriminating against or burdening interstate commerce, which is prohibited by the Commerce Clause of the United States Constitution, Art. I, sec. 8, cl. 3. Further, the First Directive discriminates against interstate commerce on its face. It directs “[t]he continuation of payments to policyholders, subscribers, and third-party claimants for claims under Insurance Policies of ROA” on one hand while, on the other hand, it refuses to make such payments for claims under insurance policies

of the Reciprocal Groups. In doing so, the Deputy Receiver may be deemed to have taken purposeful and affirmative action to favor a Virginia-domiciled insurance business and its subscribers and insureds, to the substantial and material financial detriment of the Tennessee-domiciled insurance businesses and their subscribers and insureds, who are similarly situated to the Virginia-domiciled insurer, its subscribers and insureds.

6. **Constitutionally-Prohibited Violation of Due Process Guarantees** – The Deputy Receiver’s adoption of the First and Third Directives has taken or has the substantial potential to take the property of the Reciprocal Groups and thousands of their subscribers and insureds in both Virginia and other states, without due process of law. Such action is prohibited by the Due Process Clause of Section 1 of the Fourteenth Amendment to the United States Constitution and to similar protections afforded by the Constitution of Virginia. By virtue of the First Directive issued by the Deputy Receiver, there is a substantial risk of deprivation of those property rights by the Deputy Receiver’s continued depletion of the funds of the ROA/TRG estate through continued payment of claims made under ROA insurance policies prior to a full assessment of the assets, potential assets, and liabilities of the ROA/TRG estate. Further, under the circumstances outlined herein, the Third Directive issued by the Deputy Receiver fails to provide an adequate and impartial procedural mechanism to challenge decisions of the Deputy Receiver or Special Deputy Receiver.

7. **Constitutionally-Prohibited Violation of Equal Protection Guarantees** – The Deputy Receiver’s adoption of the First Directive may be deemed to have violated the equal protection rights of citizens and residents of the Commonwealth of Virginia by discriminating against Virginia subscribers and insureds of the Reciprocal Groups whose claims are not being paid and who are similarly-situated to

the subscribers and insureds of ROA in Virginia, but whose claims are being paid. Further, the Deputy Director's adoption of the First Directive violates the equal protection rights of subscribers and insureds of the Reciprocal Groups in States other than Virginia whose claims are being paid and who are similarly-situated to the subscribers and insureds of ROA in Virginia and in other states, but whose claims are not being paid. Such action is prohibited by the Equal Protection Clause of Section 1 of the Fourteenth Amendment to the United States Constitution and by similar protections afforded by the Constitution of Virginia.

#### **V. REQUESTS FOR RELIEF**

For the reasons set forth above, the equitable nature that receivership proceedings are to take, and for the benefit of Virginia claimants, and the claimants of other states, and the public at large, we respectfully request that you:

1. Immediately stay payments from the estate to insurance claimants, which have been authorized pursuant to your First Directive, Item 1;
2. Upon consideration of this appeal, either determine that claims by the SDRs on behalf of the Groups' subscribers and/or insureds constitute "[ROA] Insurance Policy" claims, or make the stay of the First Directive permanent;
3. Direct the ROA estate to give immediate, unfettered access to the SDRs, so the SDRs may: (a) review and identify their documents, records, and property, in the possession of the ROA estate so as to identify all items belonging to the Groups; and (b) consult with officers and key personnel of the Groups;

4. Establish an informal procedure for resolution of differences of opinion between the ROA estate and the Groups as to the ownership and access issues;
5. Rescind all directives and decisions itemized in the above Statement of Objections as they pertain to the SDRs or the Groups' subscribers and/or insureds, such that this or further relief may be justly accorded to the Groups; and
6. Grant such other relief as may be warranted.

#### **VI. VERIFICATIONS**

Three verification pages are attached hereto following the Certificate of Service.

Respectfully submitted,

ROBERT S. BRANDT, Special Deputy Receiver for  
American National Lawyers Insurance Reciprocal, RRG

JOHN KNOX WALKUP, Special Deputy Receiver for  
Doctors Insurance Reciprocal, RRG

MICHAEL D. PEARIGEN, Special Deputy Receiver for  
The Reciprocal Alliance, RRG

By:

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**CERTIFICATE OF SERVICE**

I hereby certify that, on February 28, 2003, the American National Lawyers Insurance Reciprocal RRG, Doctors Insurance Reciprocal RRG and The Reciprocal Alliance RRG's Notice of Appeal, Claim, Request for Immediate Stay of First Directive as to Payments to ROA Insurance Policy Claimants, and Request For Relief From Third Directive was hand-delivered to:

Melvin Dillon  
Special Deputy Receiver  
Reciprocal of America and  
The Reciprocal Group  
4200 Innslake Drive  
Glen Allen, Virginia 23060

with copies hand-delivered to:

Alfred W. Gross  
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Bureau of Insurance  
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Walter A. Marston